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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission

In the Matter of:

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))	MM Docket No. 92-266
Rate Regulation	)	

To the Commission

JOINT PETITION FOR RECONSIDERATION

COLONY COMMUNICATIONS, INC.
CONSOLIDATED CABLEVISION OF CALIFORNIA, L.P.
CONSOLIDATED CABLEVISION OF MICHIGAN, L.P.
KING VIDEOCABLE COMPANY
MULTIVISION CABLE TV CORP.
PARCABLE, INC.
SAMMONS COMMUNICATIONS, INC.

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Summary

The Joint Petitioners commend the Commission's efforts, notwithstanding severe time and resource constraints, to create a workable rate regulation regime which attempts to avoid costly and time-consuming cost-of-service cases as the primary form of rate regulation. In order to make that process truly workable, however, certain modifications of the Report and Order are required.

Preliminarily, Petitioners urge the Commission to rectify deficiencies in the Report and Order with respect to rate adjustments and incentives for existing and future operating costs and for capital investment in system improvements. Most importantly, the Commission should not limit recovery of investment in system improvements to the GNP-PI but should permit pass-throughs of such capital costs in order to avoid a de facto freeze on system upgrades.

operators should be permitted to either recalculate their benchmark rate or pass-through actual costs, with a reasonable profit, immediately upon adding a new program service. Petitioners also urge the elimination of the distinction between affiliated and unaffiliated programmers in the treatment of pass-throughs of programming cost increases.

A further substantive pass-through issue involves the treatment of certain taxes such as the California possessory interest tax; this type of tax is a significant external cost beyond the control of the cable operator and warrants, comparable to franchise fees, full pass-through above the benchmark rate. Procedurally, Petitioners urge the Commission to permit pass-through of enumerated external cost increases above inflation since September 30, 1992 and, at a minimum, to eliminate any time gap between the time external costs eligible for pass-through are incurred and the starting date for rate adjustments on account of these costs.

With regard to cable equipment, Petitioners urge the Commission to limit its actual cost standard to devices, such as remote control devices, which are fundamental pieces of basic service equipment and to permit recovery of overhead and promotional costs associated with such regulated equipment.

Finally, the Report and Order should be modified or clarified to permit pricing to meet competition, to provide for evidentiary hearings and due process safeguards in rate cases and to permit flexibility, including settlements, in the disposition of such cases.

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Colony Communications, Inc.*, Consolidated Cablevision of California, L.P., Consolidated Cablevision of Michigan, L.P., King Videocable Company*, MultiVision Cable TV Corp., ParCable, Inc., and Sammons Communications, Inc. (hereinafter "Joint Petitioners"), by their attorneys, hereby submit their Petition for Reconsideration, pursuant to Section 1.429 of the Commission's Rules, of the Report and Order[1] adopted on April 1, 1993 to implement the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992.[2] Each of the Joint Petitioners owns and operates cable television systems, is directly and substantially affected by the Commission's rate regulation rules, and,

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* Colony Communications, Inc. and King Videocable Company are the operating companies of the Providence Journal Company.

[1] Report and Order in MM Docket No. 92-266, FCC 93-177 (May 3, 1993), 58 Fed. Reg. 29736 (May 21, 1993) ("Report and Order"; citations hereinafter will be to the pagination of the text as released by the Commission).

[2] Pub. L. 102-385, 106 Stat. 1460 (1992).

accordingly, is vitally concerned that those rules do not operate as a constraint on the ability of cable operators to provide service to the public, to invest in the development of programming and new technologies and to compete with other video service providers. In particular, the Joint Petitioners are gravely concerned that the benchmark approach adopted by the Commission affords little or no incentives or rewards for investment in technical upgrades to increase the quantity and quality of signal distribution capability and for the addition of new programming services. They recognize the severe time and resource demands imposed on the Commission by the 1992 Act's requirement to create a comprehensive and extremely complex federal rate regulation

> while protecting subscribers from noncompetitive rate levels.[3/]

The agency's recognition of a balancing of interests comports with judicial teaching that effective rate regulation must harmonize the objective of reasonable rates to consumers with the need to afford the regulated entity sufficient revenue "to ensure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[4/] As the Commission recognizes, a business enterprise is not a static activity; not only must it be able to maintain its existing business but it must be able to derive sufficient revenues to offset future operating cost increases and to attract sufficient capital to fund future growth and development.

The Report and Order properly takes cognizance of the realities of the cable business and the inadequacy of static benchmarks by the allowance of several categories of costs that cable operators may pass through to subscribers without a formal cost of service showing after the initial benchmark rate has been established. The Joint Petitioners strongly

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3/ Report and Order at 8.

4/ Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1943). See also Arrow Transportation Co. v. Southern Railway Co., 372 U.S. 658, 664-65 (1963); American Telephone and Telegraph Co. v. FCC, 487 F.2d 865 (2d Cir. 1973).

support a general "pass-through" policy.[5] However, in order to properly account for these external costs, sound regulatory policy, as well as the judicially mandated balancing of interests, requires that the Commission modify its pass-through policy in the following respects.

A. The Commission Should Establish Standards Which Permit Full Recovery of Capital Investment in System Expansion and Upgrades

Although various commenters in the initial rulemaking raised the issue of system upgrades and rebuilds, the Commission determined to defer action on that issue "at this time"; the Commission noted, however, that it would continue to monitor the issue of network improvement costs and "if it appears that this treatment is thwarting the development of new technologies and services, will review our decision as necessary."[6] The Joint Petitioners respectfully submit that the harm that will be caused by a failure to allow adequate recovery of investment in network improvements, except by either uncompensatory GNP-PI adjustments or by expensive and time-consuming cost-of-service cases, is self-evident and that the Commission should not and cannot wait until the

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[5] The Commission's adoption of pass-throughs under the 1984 Cable Act was found to be improper because the statute provided for a five percent per year rate increase for rate regulated systems. American Civil Liberties Union v. FCC, 823 F.2d 1554 (D.C. Cir. 1987), cert. denied 485 U.S. 959 (1988). No such impediment to pass-throughs exists under the 1992 Act as it is silent (unlike the 1984 Act) with regard to automatic inflationary increases.

[6] Report and Order at 161-62, n. 608.

cable industry has been "thwarted" before addressing that issue.[7]

Congress has recognized that cable plays an important role in furthering the substantial national objective of programming diversity. The 1984 Cable Act had as a stated purpose to "assure that cable communications provide and are encouraged to provide the widest possible diversity of information sources and services to the public";[8] that objective was echoed in the Statement of Policy of the 1992 Act:

> . . . ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems.[9]

Similarly, in its 1990 Report to Congress in the Cable Act Inquiry, the Commission found that:

> Deregulation under the Cable Act has fostered the intended results: increases in investment, with corresponding expansion of cable reach, numbers of subscribers, channel capacity and new programming.[10]

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[7] Evidence of the chilling effect of the new rate regulation rules on the growth and development of program services is already beginning to emerge. See, e.g. "Rules Put New Nets on Back Burner"; Multichannel News, May 10, 1993, p. 14.

[8] Section 601(4).

[9] Section 2.

[10] Report, MM Docket No. 89-600, 5 FCC Rcd 4962, 4971 (1990).

Despite the stated intentions and findings of both Congress and the Commission, the Report and Order's unwillingness to deal with system investment and its general limitation on rate increases to the GNP-PI effectively erects a virtually insurmountable barrier to the accomplishment of these objectives. Rate increases limited to the GNP-PI, which must also recover virtually all of the other operating costs incurred by the cable system, will simply be insufficient to permit recovery of costs associated with system upgrades, rebuilds and expansions, the largest single cost incurred by the cable operator after initial construction of the system.

The alternative -- cost-of-service showings -- in addition to the transaction cost in both time and money, would undercut the Commission's stated preference for a benchmark/price cap regime; in the absence of recognition and allowance of recovery of system improvements under the benchmark approach, virtually all operators who wish to upgrade or rebuild will be forced to cost-of-service cases. Thus as a practical matter many operators will simply choose to defer or delay the timing of these investments and will not keep pace with technological advances which are occurring in the cable industry.[11] Assuming a cost-of-service showing

[11] A system that fails to update its facilities and services is likely to be more vulnerable to an overbuild or other competition. It is no answer to say, however, that as (continued...)

can be made prior to actually making the investment, the operator will be required to undergo potentially protracted proceedings at both the local and federal levels, which could produce inconsistent conclusions and further appeals. Alternatively, the operator could assume the risk of the investment, subject to an after-the-fact determination of its reasonableness and the amount of recovery. Neither case is likely to be conducive to innovative research, development and growth of facilities, equipment and services. Not only will the public be deprived of the new services and technologies which could and would have been offered by the cable operator but the operator will no longer be capable of providing effective competition to a new video service provider in its market.

The Joint Petitioners submit that the Commission could and should permit recovery of capital costs for upgrades

When basing a rate increase on system improvements, the operator would be required, if requested to do so, to present its underlying calculations and rationale to the appropriate regulatory authority.[12]

By permitting the recovery of capital costs in this fashion, the Commission would eliminate disincentives to new investment, would reduce the number of cost-of-service showings, at both the federal and local level, and would appropriately balance the many important national interests contained in the Cable Act.

B. The Report and Order Fails to Adequately Address the Treatment of the Addition of New Channels of Service

As set forth above, the operator must be afforded sufficient incentive to invest in physical plant improvements, including the expansion of channel capacity. Once having done so, the treatment of new programming services added to fill those additional channels must be dealt with. The Joint Petitioners are concerned that the Report and Order does not adequately do so and that clarification is called for.

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[12] The Report and Order (n. 608) suggests that franchising authorities should have a role in weighing the costs and benefits of system improvements. While cable operators routinely consult with local authorities prior to making major system investments as a matter of prudent business practice, local political bodies should not be given an effective veto power over investment in and deployment of new technologies and services. Such a result would wreak havoc on the attainment of national infrastructure objectives as well as in multi-franchise area integrated systems.

Although the rules permit cable operators to treat increases in the costs of existing programming, on a going forward basis, as external costs and therefore subject to pass-through, it is not clear how increased costs to the operator, and a reasonable profit, attributable to adding cable program services not presently carried on the system are to be treated.[13] The Report and Order suggests that systems using the benchmark approach should be allowed to recalculate their rates on an annual basis[14] and should not be permitted to add channels of service to cure a finding of an unreasonable rate.[15] At a minimum, operators should be permitted to recalculate rates immediately upon the addition of a new channel or channels of service. To do otherwise would drastically hinder the development of new programming services and their availability to the public. The effort and expense involved in the creation and launch of a new programming service is enormous; absent this clarification the difficulties that a programmer faces in determining who

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13/ The Joint Petitioners hope that the "going forward" worksheets which the Commission has indicated it intends to release will provide needed guidance on this issue.

14/ Report and Order at 151 (basic service), 252 (cable programming service).

15/ Report and Order at 234.

his cable operator customers will be and when the service will be added to a system will be greatly exacerbated.[16]

Accordingly, the Joint Petitioners urge the Commission to modify its rules to provide that an operator may, immediately upon the introduction of new service to its channel line-up, either recalculate its permissible rate under the benchmark methodology or pass-through the entire actual cost of that programming, including a reasonable profit, whichever produces a more beneficial result. Affording the operator a choice between methods is necessary to maintain regulatory neutrality toward high and low cost services; a rate regulation regime which forces the operator to "play the system" to maximize its economic interest, regardless of whether that decision enhances program diversity or satisfies viewer preferences, is not in the public interest.[17]

Moreover, as operators adjust to the new rate regulation regime and seek new revenue sources to offset anticipated reductions in cash flow, it is critical that the Commission

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[16] These uncertainties will have the most significant adverse impact on new services which are primarily advertiser supported and thereby threaten the viability of channels which could be offered to subscribers at lower cost.

[17] The Commission's rate regulation program is in many respects like the Tax Code; both tend to influence economic behavior toward a particular result, both intended and unintended. The Commission should be extremely cautious that in pursuing its narrow rate regulation objectives it does not inadvertently induce behavior that undermines broader public

provide sufficient incentives for operators to add new programming. To accomplish this, operators should be permitted a percentage mark-up on programming costs and not be required to deduct the GNP-PI factor from the programming cost increases.[18]

C. The <u>Report and Order</u> Should Not Distinguish Between Vertically Integrated and Non-Vertically Integrated Programmers with Regard to Cost <u>Increase Pass-Throughs</u>

The Joint Petitioners urge the Commission to eliminate the distinction imposed by Section 76.922(d)(2)(vi); that section allows the pass-through in full (net of inflation) of programming cost increases imposed on cable operators by only when the programmer charges a cable operator with which it is vertically integrated an unjustifiably higher rate than that which it charges a comparable or similarly situated unaffiliated operator. No rational basis exists for an arbitrary disallowance of a pass-through solely on the grounds of vertical integration absent a showing of abuse in a specific case.

D. Clarification Is Needed of the Pass-Through Treatment of Franchise Fees and Taxes

Several of the Joint Petitioners own and operate systems in the State of California and seek clarification of the Commission's treatment of that state's possessory interest tax as an external cost.[19] Section 76.922 treats both franchise fees and certain other taxes as external costs. Existing franchise fees are allowed to flow-through and increases are to be calculated separately as part of the monthly service charge to the subscriber; other taxes are limited only to increases on a going forward basis. The only rationale offered for this distinction is that the benchmark formula and survey data do not include franchise fees.[20] Many surveyed operators who are subject to the possessory interest tax did not, however, report this item as part of

[19] The Report and Order at 338, n. 1399 indicates that this tax is not a franchise fee for bill itemization purposes; however, the decision does not appear to resolve its status as a pass-through item.

[20] Report and Order at 161-62.

their rates. Moreover, the number of operators subject to the tax is relatively small compared to the total universe of the rate survey; thus even the full inclusion of the tax in the rate survey data would have had a negligible influence on the establishment of benchmarks. However, for many operators it is a significant identifiable external cost beyond their control and warrants similar treatment as is afforded to franchise fees. Joint Petitioners strongly urge this change.

E. Cable Operators Should Be Permitted to Pass-Through Increases in External Costs Incurred Since September 30, 1992

Section 76.922(d)(2)(vi) provides that the starting date for adjustments to rates on account of changes in external costs eligible for pass-through shall be the earlier of the initial date of regulation of the tier or 180 days from the effective date of the rules.[21] The Joint Petitioners urge the Commission to eliminate any gap or delay between the time external costs are incurred and the starting date for rate adjustments on account of these costs.

As previously discussed, the benchmark approach to rate regulation is static; it produces a "snapshot" of rates in effect as of a certain date and does not reflect changes occurring after that date. A deferral of the realization of recovery of cost increases recognized to be legitimate and

[21] By its Order adopted on June 11, 1993, the Commission extended the effective date of its rules from June 21, 1993 to October 1, 1993.

entitled to pass-through will not only result in a rate which is less than compensatory and can never be fully made up but may also cause operators to delay incurring additional costs until they are eligible for flow-through. If operators are not able to recover increased programming costs and other expenses, there will be a strong incentive to delay the offering of services which would trigger these costs; no public interest purpose or benefit is served by this result.[22]

Moreover, the Commission's rate survey uses September 30, 1992 rate levels for purposes of establishing the benchmarks and the rules require roll-backs of current rates to that level, adjusted forward for inflation. Inasmuch as the Commission has determined that pass-through of certain external costs, independent of the benchmark, is appropriate, consistency requires that they likewise should be taken into the Commission should eliminate any time gap between the effective date of the rules and the effective date of eligibility for pass-through of cost increases provided for in the rules.

II. THE COMMISSION'S EQUIPMENT RATE RULES ARE OVER-INCLUSIVE AS TO EQUIPMENT COVERED AND UNDER-INCLUSIVE AS TO RECOVERY OF ACTUAL COSTS

The Report and Order establishes "standards for setting, on the basis of actual cost, the rates for installation and lease of equipment used by subscribers to receive the basic service tier, and installation and lease of monthly connections for additional televisions receivers."[24/] As detailed below, however, the Commission's newly adopted regulations are not only unduly overbroad in terms of the equipment covered but also fail to ensure that the allowable equipment rates will enable cable operators to recoup their actual costs.

A. Only Equipment Needed to Be Used to Receive Basic Service Should Be Subject to Rate Regulation

The Act authorizes the Commission to prescribe regulations regarding permissible rates for equipment "used by subscribers to receive the basic service tier."[20/] In its decision the Commission interprets this phrase broadly as including any and all equipment that could be used in

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24/ Report and Order at 170.

20/ Section 623(b)(3); 47 U.S.C. § 543(b)(3) (1993).

connection with basic service. However, a more reasonable reading of this language is that it is designed to apply only to certain fundamental equipment <u>generally used</u> to receive the basic service tier but not equipment whose use for basic service is only incidental to the primary propose or nature of the equipment.

Given that practically all equipment used to receive enhanced cable services could in some way be used in connection with basic service, there would be little reason for Congress to establish different rate standards for basic service equipment and equipment for other tiers. While it is correct that Congress altered the language of this section of the Act from "necessary" to "used" to receive basic service,[21/] Congress presumably did not intend to include all equipment that could conceivably be utilized in conjunction with basic service. Rather, it altered this language simply to include certain equipment, like remote control units, that are fundamental pieces of basic service equipment, even if they are not technically necessary to receive basic service. A remote control device is a convenience item which facilitates access to all services indiscriminately; an addressable converter, on the other hand, while it may "pass" basic service channels and incorporate remote control

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[21/] Conference Report, Cable Television Consumer Protection and Competition Act of 1992, H.R. Conf. Rep. No. 862, 102d Cong., 2d Sess. 64 (1992).

capability, is only incidental to basic service. Clearly it would not be consumer friendly nor could Congress logically have intended that the cable operator supply a cost-based remote for basic service and a separate remote for other services.

Further, the Commission's overbroad interpretation of this provision would not serve the public interest. Applying the actual cost standard broadly could inhibit system investment and further development of new equipment technologies. Because the Commission's interpretation would limit the rates charged for the vast majority of equipment to their "actual costs," operators might no longer consider research and development of such new equipment to be cost effective.

B. Permissible Rates for Equipment Must Include <u>Overhead and Promotion Costs</u>

Despite the Act's requirement in Section 623(b)(3) that equipment rates be regulated on the basis of "actual costs," the Order's equipment rate standards specifically exclude costs incurred by cable operators for overhead and promotions.

1. <u>Overhead Costs</u>

As the basis for excluding overhead costs, the Commission states that:

> . . . excluding overhead will simplify the cost showing for the Equipment Basket because a cable operator will

overhead costs in calculating permissible regulated rates in other contexts; these standards could readily be modified and applied to the regulation of cable equipment rates.

2. Promotion Costs

Cable operators commonly offer promotions to new subscribers, including a below-cost offering of certain equipment and installations. The Report and Order correctly concludes that "cable operators should be afforded substantial discretion to offer [such] promotions.[23] Not only does the customer directly receiving the promotion benefit, but so do all customers of the cable operator. Subscribers attracted to the service by promotions will increase the total number of customers, thus facilitating economies of scale with accompanying cost savings. These savings, in turn, can be passed through to all customers in